

REBUTTAL TESTIMONY ON REOPENING

of

DAVID A. BORDEN

Energy Division

Illinois Commerce Commission

**Application for Approval of Affiliated Interest Contract Between Illinois-American
Water Company and American Water Resources**

Illinois-American Water Company

Docket No. 02-0517

March 26, 2003

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6 **Q. Please state your name and business address.**

7 A. My name is David A. Borden. My business address is 527 East Capitol Avenue,
8 Springfield, Illinois, 62701.

9 **Q. Are you the same David A. Borden who previously filed Direct testimony on**
10 **Reopening in this proceeding?**

11 A. Yes.

12

13 **Purpose of Rebuttal Testimony**

14 **Q. What is the purpose of your rebuttal testimony on reopening?**

15 A. The purpose of my rebuttal testimony on reopening is to respond to the direct
16 testimony on reopening of Mr. David Kolata, on behalf of the Citizens Utility
17 Board ("CUB").

18
19 As a result of my review of Mr. Kolata's direct testimony on reopening, I provide
20 several recommendations concerning the Water Line Protection Program
21 ("WLPP"), as proposed by Illinois-American Water Company ("IAWC") and
22 American Water Resources ("AWR"), jointly referred to as "the Companies".

23

24 **Recommendations**

25 **Q. What are your recommendations concerning the WLPP?**

26 A. I have two sets of recommendations, the primary recommendations and the
27 secondary recommendations.

28 **Q. What are your primary recommendations?**

29 A. I recommend that IAWC's proposal to participate in the WLPP, as part of its
30 proposed Amended Agreement for Support Services ("the AA"), be rejected
31 because it does not satisfy the public interest standard, as set forth in Section 7-
32 101 of the Illinois Public Utilities Act ("the Act"). The public interest standard is
33 not met because IAWC's proposal fails to appropriately compensate ratepayers
34 for the net income associated with the WLPP that is made possible because of
35 IAWC's status as a public utility. Although IAWC does not propose to offer the
36 WLPP directly and I do not recommend that IAWC provide the WLPP directly,
37 IAWC could provide the WLPP instead of its affiliate, AWR. If IAWC provided the
38 WLPP directly, it could treat the net income associated with the WLPP above the
39 line for ratemaking purposes. If IAWC were to provide the WLPP and treat the
40 net income above the line, then IAWC would benefit from the WLPP via
41 regulatory lag in determining rates.

42
43 I also recommend that the Commission reject the proposed AA between AWR
44 and IAWC because the AA does not identify the services that will be provided
45 under its umbrella terms, and absent the details of such services the Commission
46 should not conclude that their provision is in the public interest. In fact, had the
47 WLPP not been identified as part of this petition, and the Commission approved
48 the AA, I believe that the Commission would have unknowingly approved a
49 service that is not in the public interest.

50 **Q. What are your secondary recommendations?**

- 51 A. If the Commission does not accept my primary recommendations, then I propose
52 the following changes to the WLPP as my secondary recommendations:
- 53 1) IAWC shall provide the same services, under the same terms and conditions
54 that it provides to AWR, to non-affiliated entities who seek to provide services
55 similar to the WLPP;
56
- 57 2) the 15% mark-up over the fully distributed cost that IAWC receives, for
58 services provided to AWR, should be increased to the percentage margin that
59 IAWC receives for the provision of customer account information to municipalities
60 for the purpose of billing for sewer service;
61
- 62 3) 100% of the mark-up that IAWC receives, regardless of whether the
63 Commission adopts my proposal or IAWC's 15%, should be treated above the
64 line for ratemaking purposes to the benefit of ratepayers;
65
- 66 4) The approval of the AA should be limited to the provision of the WLPP; and
67
- 68 5) The use of IAWC's letterhead and IAWC's endorsement of the WLPP in letters
69 to customers should be prohibited.

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71 **The Basis for the Primary Recommendations**

72 **Q. Please explain the basis for your primary recommendations.**

- 73 A. Mr. Kolata's position, as set forth in his direct testimony on reopening, is that the
74 Commission should not approve IAWC's petition unless there are changes to the
75 design of AWR's WLPP. (CUB Ex. 1.0, p.3) Absent those changes, Mr. Kolata
76 recommends the rejection of the petition. However, I believe that the petition
77 should be rejected first and foremost because it does not satisfy the public
78 interest standard. The Commission may find that Mr. Kolata's recommendations
79 and my secondary recommendations are insufficient to warrant approval of the
80 petition, and thus my primary recommendations provide a direct basis for the
81 Commission's rejection of IAWC's petition.

Q. Please explain the basis for your contention that the WLPP is not in the public interest and should be rejected by the Commission.

A. The basis for my position is that a relatively small portion of the net income associated with the WLPP accrues to ratepayers, and if IAWC were to provide the service without the involvement of AWR, then ratepayers would derive a greater benefit from the WLPP.

Q. Why do you claim that a relatively small portion of the net income associated with the WLPP accrues to ratepayers than if IAWC were to provide the service itself?

A. IAWC ratepayers are allocated half of IAWC's 15% mark-up on services that it provides AWR for the WLPP. I expect that IAWC costs will be minimal and hence the 15% mark-up will be minimal. If IAWC were to provide this service directly, without AWR, then the mark-up that AWR stands to receive under the current proposal would be shared with ratepayers directly by IAWC.

Q. Is it correct to say that you believe that if IAWC were to provide the WLPP directly, ratepayers would stand to share in the net income of the WLPP according to at least a 50/50 split?

A. Yes. Prior Commission rulings approved a 50/50 sharing of non-utility revenues, and merger savings between IAWC and ratepayers. (See the Orders in Docket No. 95-0076 and 00-0476, respectively.) While I disagree with that determination and believe that a 50/50 sharing of the entire net income associated with the WLPP is less appropriate for this service than it was for the non-utility revenues

and merger savings, a 50 percent sharing would appear to be a minimum share for customers.

Q. Why should customers be given a larger share of the net income from the WLPP than the 50/50 split that the Commission has previously approved regarding non-utility revenues and merger savings?

A. It appears to me that IAWC could provide the WLPP directly to customers without AWR, and that one possible reason for AWR's involvement is to share less of the net income from the WLPP with ratepayers, i.e., what could have been a 50/50 split of the entire net income from the WLPP is now a 50/50 split of 15% over IAWC's cost of providing the service. This hardly seems equitable given that the service is closely related to and derived from IAWC's provision of utility service. For example, AWR benefits from IAWC's use of utility personnel who repair leaks and read meters by avoiding the cost of hiring full-time employees to provide the services for the WLPP. Although IAWC charges the fully distributed cost of providing these services to AWR, such costs are likely to be minute because they are determined primarily by the amount of time the employee spends performing utility work versus the amount of time that they spend providing services for the WLPP. Based upon IAWC's description of these services, it is hard to believe that an IAWC employee would spend any significant time in their provision of services for the WLPP. AWR benefits from the access to and use of customer information that is the result of the provision of utility service without having to employ customer service and administrative employees to acquire and record such information on its own. AWR benefits from avoiding the cost of sending out

its own bill to customers for the WLPP. Finally, AWR benefits from the joint marketing of the WLPP with IAWC and thus benefits from IAWC's brand name and reputation that was built by providing service as a public utility. I do not know the economic value of IAWC's brand name and reputation, but in terms of marketing the AWR name and reputation to utility customers, AWR could not duplicate the value of the IAWC brand name for the WLPP.

Q. Why do you believe that IAWC can provide the WLPP instead of AWR?

A. As the WLPP is proposed, IAWC provides its endorsement and brand name to AWR to market the service to customers, but IAWC could endorse and market the service without AWR and the Commission would not have to calculate the worth of IAWC's brand name and whether AWR is charged appropriately for its use. IAWC provides customer account information to AWR and such information could be used by IAWC to identify customers participating in the WLPP for the same cost that IAWC proposes to provide the service to AWR. IAWC proposes to provide the use of its bill to collect payment from customers on behalf of AWR, but IAWC could similarly use its bill to collect payment for its provision of the WLPP at no additional cost. Both IAWC and AWR use the same billing system provided by an affiliated service company and that would continue with IAWC providing the service directly. IAWC proposes the use of its utility personnel to respond to repair calls and identify whether a condition exists that AWR is responsible to repair, but IAWC utility personnel could do the same for IAWC for the same minimal cost. IAWC could contract for the licensed plumbers to perform the actual repair work that is currently contemplated by AWR and it is

unlikely that the costs would be different. In terms of actual experience in providing these types of customer repair services, utilities provide all of the work in the telecommunications industry and most of the work for the one gas pipe repair service that was discussed in my direct testimony on reopening. (ICC Staff Exhibit 2.0, pp. 8-11) For all of these reasons, I conclude that the WLPP is closely related to and derived from utility service and could be provided directly by IAWC for the same or very similar costs versus AWR.

Q. Is it correct that you recommend that the Commission reject IAWC's petition, but you do not recommend that the Commission order IAWC to provide the WLPP?

A. Yes. I do not recommend that the Commission order IAWC to directly provide the WLPP. My previous testimony describing why IAWC could provide the WLPP without AWR is intended to demonstrate why the public interest standard is not met and not to recommend that IAWC be mandated by the Commission to provide the WLPP. That decision should be left to IAWC.

Q. Your remaining primary recommendation is that the Commission should reject the AA between AWR and IAWC. Please explain the basis for this recommendation.

A. CUB witness Kolata recommends that the section of the AA, that permits IAWC to provide other unidentified services to affiliates, should be eliminated from the AA. (CUB Ex. 1.0, pp.3, 10-12) I agree with Mr. Kolata's recommendation. The AA does not identify the services that will be provided under its umbrella terms, e.g., see the AA, Section 6.1.4 Other Services, and absent the details of such

services the Commission should not conclude that the provision of unknown services is in the public interest. In fact, had the WLPP not been identified as part of this petition, and the Commission approved the AA, I believe that the Commission could have unknowingly approved services, such as the WLPP, that would not be in the public interest.

Q. Is it your position that the Commission should begin changing its approach to the approval of general service agreements for all utilities such that greater specificity regarding the proposed services is required before the Commission considers approval?

A. Yes. Although the Commission's approval of agreements may be warranted for services that are specifically identified, the Commission should reconsider its approach to the approval of general service agreements that do not set forth the details of the services to be provided between the utility and its affiliate. Some of the services intended to be provided under general service agreements should not be approved by the Commission in advance because the Commission may find the specific details of the services objectionable. In addition, conditions in the industry may change over time such that what was once thought to be in the public interest can turn out to be something the Commission would have rejected had it anticipated a greater number of potential services under the general agreements. By approving general service agreements the Commission is saying that all of the services provided under those agreements are in the public interest, and it is not possible for the Commission to reach this conclusion

reasonably without knowing all of the intended uses of the agreements and the details of the services provided.

The Basis for the Secondary Recommendations

Q. Earlier in your testimony you presented your secondary recommendations regarding the WLPP. Please restate your secondary recommendations and explain the basis for your secondary recommendations.

A. My secondary recommendations are as follows:

If the Commission does not accept my primary recommendations, then I propose the following changes to the WLPP as my secondary recommendations:

1) IAWC shall provide the same services, under the same terms and conditions that it provides to AWR, to non-affiliated entities who seek to provide services similar to the WLPP;

2) the 15% mark-up over the fully distributed cost that IAWC receives, for services provided to AWR, should be increased to the percentage margin that IAWC receives for the provision of customer account information to municipalities for the purpose of billing for sewer service;

3) 100% of the mark-up that IAWC receives, regardless of whether the Commission adopts my proposal or IAWC's 15%, should be treated above the line for ratemaking purposes to the benefit of ratepayers;

4) The approval of the AA should be limited to the provision of the WLPP; and

5) The use of IAWC's letterhead and IAWC's endorsement of the WLPP in letters to customers should be prohibited.

Q. Please explain why IAWC should provide the same services, under the same terms and conditions that it provides to AWR, to non-affiliated entities who seek to provide services similar to the WLPP.

A. Mr. Kolata testifies that IAWC should guarantee that IAWC will provide similar services to non-affiliated companies at reasonable rates if requested. (CUB Ex.

1.0, p.3, 12) I agree with Mr. Kolata's position because when IAWC provides these services under the same terms and conditions to non-affiliated entities, IAWC is less likely to subsidize its affiliate in the use of IAWC's personnel, services, and information in the provision of non-utility service, and IAWC can maximize the value of the personnel, services and information to the benefit of ratepayers. For example, if IAWC were required to provide similar services to unaffiliated entities, then the terms and conditions to provide those services are more likely to result from arms length transactions versus terms and conditions negotiated with an affiliate. The Commission can use the terms and conditions with unaffiliated entities as an indication whether IAWC subsidizes its affiliate. It is not in the public interest for IAWC to subsidize the cost of the services that it provides to its affiliate because such subsidization means that rates to ratepayers are higher than they might be otherwise.

As long as IAWC receives the same mark-up, utility service is not impaired, and ratepayers benefit from the net income generated by the services, then the Commission should require that IAWC provide the same services that it provides to AWR to non-affiliated entities. Such treatment would be in the public interest because, to the extent other providers began offering the service to customers and IAWC's net income associated with the provision of these services increased, then the sharing of a larger amount of net-income associated with IAWC's provision of the service would benefit ratepayers and reduce the over all cost of utility service.

250 **Q. Please explain why the 15% mark-up over the fully distributed cost that**
251 **IAWC receives, for services provided to AWR, should be increased to the**
252 **mark-up that IAWC receives for the provision of customer account**
253 **information to municipalities for the purpose of billing for sewer service.**

254 **A.** Mr. Kolata cites the Commission's Order in Docket No. 00-0586, as providing
255 that "gas utilities shall not provide any preferences to affiliated interests in the
256 release of billing and usage data." (CUB Ex. 1.0, p.12) The Commission must
257 treat IAWC similarly because the public interest standard includes a
258 determination as to whether IAWC subsidizes its affiliate via affiliate transactions.
259 In my opinion, the 15% mark-up constitutes a subsidy to IAWC's affiliate AWR
260 because it appears to be below market based on the margin that IAWC earns
261 from the provisions of similar services to municipalities.

262
263 Since IAWC and AWR are affiliates, the Commission should assume that the
264 negotiations between IAWC and AWR are not at arms length. Rather than rely
265 on the assurances of affiliated companies who face an incentive to lower the
266 mark-up, the Commission should rely on the contracts that IAWC has negotiated
267 to provide similar services with unaffiliated entities and the resulting profit
268 margins associated with those services. IAWC provides customer account
269 information to various municipalities so that the municipalities can bill those
270 customers for sewer service. IAWC meter reading and service employees are
271 used to provide this service in much the same manner as they are used by IAWC
272 to provide similar services to AWR. In its response to Staff Data Request DB-

2.1, dated March 4, 2003, IAWC indicates that the revenues associated with this service are \$152,253, and the expenses are \$15,058, for the test year in IAWC's ongoing rate case, Docket No. 02-0690. I conclude from this data that the net income from these services is \$137,195. The net income earned by IAWC on these services is not based on a percentage mark-up over cost, but on a negotiated per customer charge for reading meters that is set forth in the contracts. The net income for the test year constitutes a 911% margin on the services provided. I recommend that the Commission replace the 15% mark-up over the services that IAWC will provide to AWR with a 900% mark-up over IAWC's fully distributed costs of providing those services to AWR.

Q. Please explain why all of the mark-up that IAWC receives above IAWC's costs of providing services to its affiliate for the WLPP should be treated above the line for ratemaking purposes to the benefit of ratepayers.

A. Mr. Kolata's recommendations address the joint participation of IAWC and AWR in providing the WLPP. (CUB Ex. 1.0, p.3) It is possible that the joint participation is intended to subsidize AWR's provision of the WLPP through a greater sharing of the gain associated with the WLPP than had IAWC provided the service directly. My 100% sharing proposal is an attempt to re-capture some of the gain that might otherwise have gone to ratepayers had IAWC proposed to offer the WLPP directly. If IAWC were to provide the WLPP directly and followed the same proposal in this proceeding to share the mark-up above IAWC's cost of providing services to AWR 50/50 with ratepayers, then ratepayers would have received 50% of the net income associated with the WLPP. Undoubtedly, 50%

of the entire net income associated with the WLPP is greater than 15% above IAWC's cost of providing services to AWR.

Q. Do you know whether a 100% sharing for ratepayers of a 900% mark-up above IAWC's cost will result in the WLPP being uneconomical to AWR?

A. No, but I asked IAWC for the economic analysis on which the decision to implement the WLPP was based. (Staff Data Request DB-1.11, dated February 27, 2003) In its response, dated March 7, 2003, IAWC states:

The program was approved by the then President of AWR, Ray Lee. Mr. Lee has since retired and to our knowledge no economic analysis has been retained.

Since I do not know the economic basis for implementing the WLPP, and AWR no longer has this information, I cannot say whether my proposal would impair the WLPP such that AWR would no longer find it profitable to offer to customers.

Q. Please explain why the approval of the Amended Agreement for Support Services should be limited to the provision of the WLPP.

A. Mr. Kolata recommends that Section 6.1.4 of the AA be eliminated. (CUB Ex. 1.0, pp. 3, 10-12) I agree with Mr. Kolata's recommendation. As stated previously in my testimony, the AA does not identify the services that will be provided under its umbrella terms, and absent the details of such services the Commission should not conclude that the provision of unknown services is in the public interest. In fact, had the WLPP not been identified as part of this petition, and the Commission approved the AA, I believe that the Commission could have unknowingly approved services, such as the WLPP, not in the public interest. Although the Commission's approval of agreements may be warranted for

services that are specifically identified, the Commission should reconsider its approach to the approval of general service agreements that do not set forth the details of the services to be provided between the utility and its affiliate. Some of the services intended to be provided under general service agreements should not be approved by the Commission in advance because the Commission may find the specific details of the services objectionable. In addition, conditions in the industry may change over time such that what was once thought to be in the public interest can turn out to be something the Commission would have rejected had it anticipated a greater number of potential services under the general agreements. By approving general service agreements the Commission is saying that all of the services provided under those agreements are in the public interest, and it is not possible for the Commission to reach this conclusion reasonably without knowing all of the intended uses of the agreements and the details of the services provided.

Q. Please explain why the use of IAWC's letterhead, and IAWC's endorsement of the WLPP in letters to customers should be prohibited.

A. Mr. Kolata recommends several changes to the language set forth in IAWC's letter endorsing the WLPP. (CUB Ex. 1.0, pp. 3-10) I recommend approval of Mr. Kolata's recommendations only if the Commission does not adopt my recommendations prohibiting the use of IAWC's letterhead and IAWC's endorsement of the WLPP. I view Mr. Kolata's recommendations as a second best solution to the joint marketing problem because subsidy concerns still remain with respect to the cost of IAWC's brand name and reputation, and

because evaluating all of the words and phrases of the letter may be more difficult in practice. Since I believe that subsidy concerns remain when IAWC joint markets with AWR and since IAWC has not substantiated the claims in the letter, I do not recommend that they use their name and utility service to market the WLPP.

IAWC endorses the WLPP in IAWC's letter that markets the program to customers. (IL-AWC Exhibit 2.0) The Commission does not know the value of IAWC's brand name and reputation, and absent similarly negotiated services with an unaffiliated entity, the Commission does not have a reasonable proxy for IAWC's brand name and reputation. Thus, the Commission does not know whether the use of IAWC's brand name and reputation, under the terms of the WLPP, constitutes a subsidy to AWR. Since it is not in the public interest for the Commission to allow IAWC to subsidize services provided to AWR, I recommend that the Commission prohibit IAWC's endorsement and joint marketing of the WLPP.

In addition to subsidy concerns, I am concerned about IAWC's endorsement of a service that benefits from IAWC's provision of utility service when it is not known whether the WLPP provides an economic benefit to customers. Since I have not reviewed the economic analysis of the WLPP, because it is not available from AWR, I do not provide an opinion as to whether the service is likely to be beneficial to customers. I also do not understand how IAWC can endorse a

367 program under such circumstances. As such, I am opposed to the Commission
368 authorizing IAWC's endorsement and marketing of the WLPP, which could be an
369 unnecessary purchase for the vast majority of customers. That is to say, it is not
370 in the public interest for the Commission to authorize IAWC to provide potentially
371 inaccurate or misleading information to customers in its marketing of the WLPP.

372 **Q. Does this conclude your rebuttal testimony on reopening?**

373 A. Yes.

374